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Can the Global Neoliberal Regime Survive Victory in Asia? The Political Economy of the Asian Crisis

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Can the Global Neoliberal Regime Survive Victory in Asia?
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> The Crisis consists precisely in the fact that old is dying and the new cannot be born; in this interregnum, morbid phenomena of the most varied kind come to pass.
>
> – Antonio Gramsci (Prison Notebooks, 1996)

I. Introduction

The sequence of events that is still denoted the "Asian" financial crisis has now produced a global economic crisis. It began with the destabilization of several Southeastern Asian currencies in summer 1997. By summer 1998, Wall Street had lost momentum. The IMF's inability to stop Russia's mid-summer crisis then turned the cracks in Wall Street's dizzy consensus concerning the end of history into gaping holes. Traders worldwide ran for safety, leading to spasmodic new rounds of currency and equity-market collapses in Latin America and Asia.

Merely documenting what has happened will fill volumes. We focus here first on the architecture of the crisis as a whole, and then on one case: South Korea. There are several reasons for choosing Korea. First, it occupies the pivotal place in the sequence of events: the tsunami that built up in Southeast Asia hit the Republic of Korea with full force in fall 1997, and lingered there through the spring before assaulting New York, Russia, and Latin America in summer 1998. Second, Korea is perhaps the prototype for the Asian developmental model. Third, we have observed the Korean situation firsthand. In effect, Korea provides us with a lens for viewing the innumerable layers of crisis in the current situation.

Our central point is that the essence of the current crisis is its inherent structural complexity; it cannot be reduced to a single mechanism operating at a single behavioral level, but involves instead a series of interlinked conflicts operating at several levels simultaneously. Understandably, most analysts have focused on one or the other contributing causes in this crisis. Some have tried to identify a flawed microfoundational mechanism of the "Asian model"—for example, Krugman's (1998) model of perverse borrower-lender relations due to unwise government guarantees. Others

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have emphasized national policy mistakes—for example, Grabel's (1998) argument that over-reliance on hard-currency foreign loans without controls over portfolio investment flows triggered many recent financial crises. Still others have emphasized flaws in the structure of international markets – for example, Paul Davidson's (1998) view that the Asian crisis reflects liquidity-shortage chickens coming home to roost in the post-Bretton Woods world.

We find much to agree with in these works. But we do not think the crisis in its current form could have resulted only from problematic microeconomic design, flawed national strategy, or a perverse international environment. Rather, the current crisis has arisen simultaneously as a conflict between international and national forces, on one hand, and as localized struggles between capital and labor, on the other.

The crisis is thus inherently international, national, and class-based all at once. In our view, no single behavioral cause or design flow can be identified as having nudged the End-of-History ship toward the iceberg. Instead, this crisis has arisen due to long-term contradictions embedded in the structures and policies of the global Neoliberal regime, political and economic contradictions internal to affected Asian nations, and the destructive short-term dynamics of liberalized global financial markets. The system is broken at so many levels that serious study of the structured complexity of global conflict must precede proposals for institutional and policy change designed to solve the many problems created by the crisis.

The sections that follow first discuss the transition from the Golden Age system to the global Neoliberal regime, and then the myths and reality of the East Asian economic model. We then provide an overview of the Asian crisis, emphasizing the fundamental structural incompatibility between this model and the Neoliberal regime. After critically evaluating the use of mainstream equilibrium-based models to understand the Asian crisis, we provide a more detailed discussion of the crisis in Korea. We end with some reflections on policy.

II. From the Golden Age to the Global Neoliberal Regime

The so-called Golden Age of modern capitalism, lasting from World War II through the early 1970s, was built on the foundation of state regulation of the economy.[1] In the international financial system, exchange rates were fixed relative to the dollar, which in turn was pegged to gold. Significant barriers to capital mobility were in place. Domestically, governments in the North operated managed capitalist systems. They controlled aggregate demand to meet unemployment and inflation targets; they regulated business and finance, established rights for workers, redistributed income via the tax/transfer system, and underwrote a social safety net. In the workplace, a period of relative labor-capital peace was achieved through widespread adoption of what has been termed the Fordist production model. Economic output was centered on capital-intensive goods manufactured in large-scale facilities by largely unionized workforces. Many workers obtained higher real wages and gains in job security and workplace safety. Admittedly, experience in the countries of the South was extremely varied, in large part because many nations were emerging from neo-colonial domination by European powers. Fueled by high Northern growth rates, much of the South did achieve sustained expansion.

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[1] This concept is introduced and explored in Glyn, Hughes, Lipietz, and Singh (1990).

The Golden Age's increasing prosperity did not, however, create capitalism without conflict. The struggle within each nation among firms and workers over wages, relative prices, and working conditions continued unabated. And economic conflict among nations did not cease. During the Golden Age, the capital-labor class conflict was mediated by gains-sharing contracts that raised real wages; and national-capital conflicts were obviated by the Pax Americana within which the Bretton Woods system operated. These resolutions were, to some extent, mutually reinforcing. The top portion of Figure 1 demonstrates this point, using arrows to indicate causal influence. That is, the fixed-exchange rate regime facilitated the pursuit of Keynesian demand management built on redistribution and high employment; this created a political environment in which the public supported these policies, ensuring their continued implementation. Firms meanwhile engaged in co-respective competition based on (and thus expanding) the use of high-wage, high-productivity labor.

But eventually this solution came undone. The balance of power between domestic governments and real and financial capital seeking international mobility swung decisively toward the latter in the 1970s. This in turn legitimized a free-market revolution in economic policy, pursued most successfully by conservative politicians and economists in the US and the UK in the early 1980s. With the Golden Age in ruins, the Reagan and Thatcher Administrations put the Neoliberal regime into place.

The defining elements of the Neoliberal regime are deregulation, privatization, and liberalization—that is, a contraction of the state's role in an increasingly integrated global economic system. The hallmark of Neoliberalism is the pursuit of unregulated markets almost everywhere for almost everything. These economic relations are supported in the ideological realm by the dominance of Neoliberal economic and political theory—even within economics departments in Asian countries.

Guiding the emergence of this order are the G7 nations, especially the United States, together with the multinational corporations and banks of the North (and, increasingly, of the South). Supporting these agents are domestic elites, North and South, and a set of four multilateral institutions--the International Monetary Fund (IMF), the World Bank, the World Trade Organization, and the Bank for International Settlements (BIS). The United States has stood at the apex of global economic power both in the Golden Age and in the Neoliberal regime. The hallmark of the Neoliberal order, however, is the power of global rentiers. The past two decades have seen the construction of a globe-girdling network of financial centers and off-shore financial havens. These centers and firms provide an infrastructure for financial speculation; the instability of exchange rates and interest rates in the Neoliberal regime provide the requisite motivation.

The threat of nearly instantaneous cross-border capital movements triggered by speculative motives in turn has imposed severe constraints on state economic policies. Indeed, managed capitalism has been moving in the direction of laissez-faire capitalism. Monetary policy now aims at lowering inflation, not unemployment; safety-net and social-welfare programs have been cut; the counter cyclical role of government expenditure in sustaining aggregate demand has been virtually eliminated; business has been deregulated; and workers' rights have been restricted. The nations of the South are expected to follow suit if they expect to continue to trade with the North.

Economic conflict in the workplace is also resolved differently than in the Golden Age. The

Fordist production model has been largely replaced by the "post-Fordist" model, featuring substantial use of subcontracting, often with bid-price competition, just-in-time inventory methods, and out-sourcing. Together with the erosion of income-transfer programs and state protection for workers, this has led to less gain-sharing by firms; regressive redistribution from labor to capital thus has helped sustain profits just they were being eroded by increased interest payments. Many firms have taken advantage of the ease of capital mobility to adopt the global factory model, in which components are manufactured and assembled in multiple off-shore locations.

Advocates of Neoliberal policies have argued that they would yield better national and global economic performance than in the Golden Age--higher GDP, employment, and productivity growth. Technology transfers from the North would let less developed nations converge to the developed nations' level of economic performance. Such projections have proven to be wide of the mark. Neoliberal policies have generated higher profits for some multinational firms and banks, and much higher returns for rentiers throughout the world. But for most people, Neoliberalism's promised benefits have not materialized. In the North, economic growth rates have been well below historical trends. European unemployment has hovered near depression levels for a decade while in the US, median real wages have substantially declined and inequality has risen dramatically since the late 1970s. In much of the South, the situation is even worse. Latin America had its "lost decade" after the Mexican debt default of August 1982. Eastern Europe's economies have stumbled badly after a widely heralded start.

The most recent Trade and Development Report of (UNCTAD, 1998) points out that global economic growth averaged just 1.9% between 1990 and 1995; it rose to 3.0% in 1996, and further to 3.2% in 1997—largely because the effects of the Asian crisis were not yet felt. But it is projected to fall to 2.0% in 1998, perhaps to fall further in 1999. In the entire 1990-97 period, the economies of the developed nations have grown more slowly, on average, than the global economy as a whole—an average of 1.7% in the 1990-95 period, 2.5% in 1996, 2.7% in 1997, and 1.8% in 1998 (projected). East and Southeast Asia and the US are the only areas of the globe to have generated consistently high growth rates in the Neoliberal era.

Why is Global Growth Stagnant?

Weak global growth rates in the Neoliberal regime can be traced to two mutually reinforcing, fundamental problems: (1) chronically insufficient growth in aggregate demand; and its flip-side, (2) chronic excess aggregate supply. The structural tendency of the Neoliberal regime to generate chronically inadequate aggregate demand growth provides the context within which the outbreak of the Asian crisis can be best understood.

Here we identify five interconnected roots of weak global aggregate demand deeply embedded in the structures of the Neoliberal regime. First are a series of forces holding down wages and mass consumption. These include the threat of capital mobility (which, in the case of FDI, is underestimated by the measured volume of capital mobility)[2]; rising import competition; and chronic

[2] One reason why wage effects of foreign direct investment are dismisses is that the tests designed to measure its impact are badly flawed. See Crotty, Epstein, and Kelly (1997), on which this section draws heavily.

job “churning,” which can be traced both to technical change and to new corporate strategies of downsizing and re-engineering. In effect, changes in laws and technology made it feasible for multinational corporations to substitute low-wage Southern labor for equally-skilled but higher-paid Northern labor.[3] It bears emphasis that these anti-worker corporate policies were made possible by two prior shifts in government policy: the erosion of support for unions and regulated labor-capital bargaining; and the slow deconstruction of social safety nets, which made workers’ exit option less attractive.

The second factor depressing global growth rates is the high real interest rate regime created by independent central banks and reinforced by global rentiers. This monetary-policy shift coincided with the elections of Reagan and Thatcher, who helped create a secular increase in the reserve army of the unemployed and thus forced the costs of the global crisis of the 1970s and early 1980s onto workers. This shift in monetary policy was reinforced by the rising power of global rentiers in the 1980s in the wake of financial deregulation. The rentiers were able to punish countries that used policy to pursue growth and employment rather than low inflation.

A third factor was the emergence of restrictive fiscal policy. The high interest-rate regime played a role: rising interest payments eat up larger shares of public spending, all else equal. But more important, lower taxes and a shrinking social safety net have been the political order of the day. The importance given to austere fiscal policy was recognized explicitly in the criteria established under the Maastricht treaty. Further, rentiers and independent central banks together punished countries that ran excessive deficits.

A fourth factor was the level and character of global investment. Investment spending in the Neoliberal regime has been, on average, low, due to high real interest rates and sluggish aggregate-demand growth. But beyond this, much investment was labor-saving rather than capacity-expanding: thus, the increased aggregate demand created by investment spending has often been counteracted by cuts in worker consumption caused by the job and wage losses associated with this investment.

The final factor explaining low aggregate demand is the role of the IMF. As more developing countries experienced national insolvency, the IMF has increasingly played a new role—lender of last resort to countries with inadequate foreign exchange reserves. The IMF has invariably mandated austerity macroeconomic policies plus Neoliberal restructuring in return for its money. The growth of IMF austerity programs around the developing world (not to mention the self imposed macro-economic austerity programs adopted by countries like Brazil to avoid falling under the control of the IMF) has left global aggregate demand even more constrained.

Why hasn’t supply adapted to reduced demand growth? In the Neoliberal regime, demand problems have generated destructive competitive processes which, in turn, have aggravated demand deficiencies. The Neoliberal regime has replaced the “co-respective competition” (to use Schumpeter’s phrase) among large firms in the Golden Age--characterized by long-term planning horizons, restrained capital-labor conflict, and avoidance of those dimensions of competition that

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[3] Another factor depressing global wages was the entry of workers from China, the former Soviet Union, and India into the global labor pool in this period.

undercut industry-wide profitability, with "coercive competition" based on predatory pricing, overinvestment, waves of technological innovation that render recently constructed capital goods obsolete (and the debt used to finance them potentially unpayable), and aggressive regimes of labor policy.[4] The key is to understand why the Neoliberal regime has forced competition into a coercive and destructive mode.

The modern global economy has a discrete number of key manufacturing, service and financial industries that dominate international trade and investment--such as banking, insurance, autos, airplanes, computers, semiconductors, electric appliances, steel, and machine tools. Mature industrialized countries have large multinational corporations that desire to maintain their traditional domination of these key industries. In addition, however, developing countries moving up the technology/productivity/value-added ladder--such as Japan, Korea and Taiwan — must establish footholds, followed by strongholds, in many of these same industries. So each new wave of entrants, like the countries of South East Asia in recent decades, further crowds these global markets. If global and Northern aggregate-demand growth was strong, this problem would be contained to some degree. But, as we have seen, it is not; the Neoliberal regime severely constrains the growth of demand. In the absence of exit by established players, waves of new entrants leads to chronic overcapacity, low profits for many firms (except at cyclical peaks), fierce competition, and a deflationary bias in global commodity markets.

Given the centrality of these markets and the sunk costs required to enter them, most competitors try to stay in the game even as competition mounts, hoping to survive current struggles so they can reap the high profits expected to emerge when the losers are eventually forced out. Consequently, they tend to over-invest, building plants in areas with cheaper labor and/or adding cutting-edge technology. In markets such as semiconductors and airplanes, best-practice technology requires huge investment. Ironically, investment aimed at insuring competitive strength simultaneously generates risk. Over-investment in a period of low profit rates and high interest commitments requires many firms to use high leverage. While high leverage is a well-known feature of Asia's economies, rising leverage occurs in any system with high investment levels, falling profits, and high interest burdens.

In neoclassical textbook models, the downward pressure on profits, capacity utilization, and prices is soon eliminated by the exit of firms to industries with higher profits. But in the Neoliberal regime, it is reproduced, because entry is not matched by exit. The more these pressures develop, the more they force firms to cut wages, smash unions, move to areas of cheaper labor, and push for tax cuts and other government policies which restrict aggregate demand—one of the major causes of the excessive competitive pressures in the first place. The elements causing slow aggregate-demand growth and excess aggregate supply thus reinforce one another in a vicious circle.

The pattern of excess supply leading to coercive competition in the real sector is repeated in the financial sector. In the wake of continuing financial deregulation, removal of capital controls, and technical change, large banks are forced to compete globally for up-scale customers.[5] Accompanying this trend is a shift in these banks' revenue generation from traditional intermediation (lending to

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[4] See Crotty (1993) on the importance of this shift in competitive regimes.
[5] See Dymski and Isenberg (1998) and Dymski (1999).

hold) to fee-based income (lending to sell). This shift reflects both the premium placed on liquidity in the uncertain economic climate of the Neoliberal order, and also banks' reluctance to absorb default and other risks in this climate. However, in shifting away from intermediation and toward fee-based activities, banks are moving into heightened competition both with investment and brokerage firms and with one another. Increasingly, high profits can be obtained in the financial sector only in two ways: by opening up new lending venues and enjoying a scarcity rent on funds lent; or by taking on highly-leveraged excessive risks. Events in recent months have made it clear that the bets these players take can jeopardize the stability of the entire global financial system.

In sum, the step-by-step dismantling of Keynesian policies from the mid-1970s onward and the freeing of capital movement have pushed the world's economies deeper into a Neoliberal economic trap which increasingly shuts in on itself. As the bottom portion of Figure 1 illustrates, Pax Americana and the fixed exchange-rate regime no longer set the tone for global economic policy, as in the Golden Age; multinational firms and mobile capital do. Restrictions on state action reduce the scope for redistributive policies and hence erode mass support for lift-all-boats efforts. This in turn eliminates Keynesian employment-based demand management and leaves states with price stability targets, contributing to a global deflationary bias.[6] The Golden Age political consensus in favor of Keynesian demand management, market regulation, and income redistribution now appears to be an exercise in hopeless utopianism; replacing this consensus is a global sense of pessimism on the part of national electorates, whose erstwhile leaders have conditioned them to expect nothing and hope for nothing.

III. The East Asian Model : Myths and Reality

This brings us to the East Asian model itself. The shock-waves emanating from this region's current crisis should not cause us to forget East Asia's immense long-term achievements. The prototype was Japan in the 1950s "income doubling" period, while from 1961 through 1996, South Korea's average annual rate of growth of real per capita GDP and real wages averaged about 7% per year. Though East and South East Asia constitute about 25% of global GDP, in the 1990s about half of the growth of world GDP has originated in this area. Ajit Singh recently observed that: "It is no exaggeration to say that the post-World War II development of East Asia (including Japan) is the most successful story of sustained economic expansion in the history of mankind" (Singh, 1996).

This economic success has been achieved through a structure of state-led growth originated in Japan, refined in the four "Tigers" (South Korea, Taiwan, Singapore, and Hong Kong), and subsequently adapted for use in South East Asia, China, and elsewhere. The beginning of wisdom about the East Asian model is the recognition that it has differed substantially from one country to another, and within countries from one period to another.[7] This variability has allowed analysts to explain the elements behind East Asia's brilliant economic performance very differently. Marcus Noland has remarked in private correspondence that East Asia has been a mirror, in which many analysts have seen the reflections of their own preconceived ideas. For example, some economists

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[6] Galbraith (1998) analyzes recent global exchange-rate trends. Blecker (1998) documents the global contractionary bias of government policy.

[7] For example, Korea's industrial strategy was made over substantially in the 1970s, and again in the early 1980s, both to correct policy mistakes and to respond to an evolving international environment; see E.M Kim (1997).

have attempted to attribute the success of Taiwan, and East Asian economies more generally, to their pursuit of policies that a market-oriented economic approach would have dictated anyway--despite voluminous evidence to the contrary (Wade, 1990).

It is thus important to be clear on the essential features of the Asian model—what this model is and is not. A common misimpression regards the Asian model as controlled by a giant predatory state which monopolizes national output and builds wealth by running aggressive trade surpluses, and devalues its currency aggressively to maintain its edge in global markets. Reality is far more complex. First, the government accounts for no larger a share of output in East Asia than elsewhere. Further, East Asian countries do not uniformly run trade surpluses. Figure 2 shows that Korea and Thailand have more often run trade deficits than surpluses. In the 1990s Korea has consistently had trade deficits with both the US and Japan. As for chronic currency devaluations, Figure 3 shows that throughout the 1980s and 1990s, two East Asian currencies (the Japanese yen and Taiwanese dollar) have risen substantially against the US dollar, while three others held their value against the dollar until the 1997 crisis period.

What then are the points of commonality in the East Asian model? First is the shared structural circumstances and historical legacy of nations in this portion of the world. Of special importance is the relative paucity of mineral resources and oil, which helps explain the centrality of trade considerations in these nations' policies. Second, and most important, is the fact of heavy state involvement in the allocation of resources. This has been referred to in the literature as the developmental state (Johnson, 1995) or late industrialization (Amsden, 1989). For example, until the recent crisis period, the Korean government provided temporary import protection for domestic markets introducing new products or technologies, channeled the development of high tech production capabilities to a small number of diversified companies (called *chaebol*), allocated credit toward priority industries and technologies, and tightly regulated the cross border movement of money. At the same time, the government selectively opened markets to import competition and imposed export performance criteria in return for government aid to insure that key industries achieved world-class efficiency. Such heavy involvement in investment and savings flows is present even when the apparent level of government involvement is relatively slight, as in Taiwan. Strong government guidance is, of course, antithetical to Neoliberalism, but it did lead to high investment levels, as Figure 4 illustrates. The US investment share of GDP hovers just under 20%; Malaysia' and Taiwan's shares have trended downward to about 25%; but Japan's share has remained at about 30%. Investment shares in Korea and Thailand have climbed over 35% in the 1990s.

The Asian economies are tightly integrated. This close relationship is demonstrated in Figure 5. The US GDP growth rate is relatively independent of the East Asian rates, which instead vary closely with Japan's cyclical growth rate. In 1996, about 52% of Asian exports, and 54% of its imports, were intra-regional (UNCTAD, 1998, page 27). The apparent pattern of dependence on Japan is not surprising given the sheer scale of the Japanese economy, whose GDP is about 12 times as large as Korea's. That the Korean economy was, until the 1997 crisis, the eleventh largest in the world, makes this mismatch all the more remarkable.

Another theme of East Asian development has been deferred gratification for consumers. Tight constraints have been imposed on the domestic consumer goods market in order to free up resources for investment and exports. Current consumption has been sacrificed for high rates of capital accumulation, and thus for future consumption. The guiding idea has been that household needs would be met by the sheer pace of growth.[8]

Finally, East Asia has been understood to be reasonably free from the overt capital-labor conflict that has often characterized Western labor markets and labor processes. The exchange of the security of lifetime employment for worker loyalty in pursuit of company objectives is often seen as key components of the Japanese and Korean 'miracles'.

But the deferred-gratification/low-conflict features of the Asian model should not be exaggerated or romanticized. Rapid growth, relatively flat pay scales, and flexible supervisory methods have often kept capital-labor conflict in the background. But political repression including the destruction of independent, democratic and militant unions has played a crucial role as well--and continues to do so in the restructuring processes imposed by the IMF after the crisis began. Further, the avoidance of overt capital-labor conflict is due in part to the heavy industrial use of female labor in the context of long-standing gender-based oppression. But the case of Japan shows that the long-term price of playing the gender card in industrial development is the 'revolt' of women, which can jeopardize the reproduction of social relations in several ways (see Naff 1994). Further, housing remains inadequate, especially for lower-income people (Ha, 1995; and W.J. Kim, 1997). And democratic participation has been restricted--at times outlawed, encouraging the entrenchment of powerful economic and political elites (E.M Kim, 1997).[9]

IV. The Emergence of the East Asian Crisis: An Overview

In this section we make two arguments. First, that the fundamental structural incompatibility between the Neoliberal regime and the East Asian model guaranteed that the Asian economic miracle would inevitably be disrupted at some time, in some way. Second, that the financial liberalization imposed on Asia by external and internal elites, in the context of the global financial regime, set the stage for the timing and character--the conjunctural and contingent characteristics--of the Asian crisis of late 1997. We see these two arguments as addressing, respectively, the ultimate and proximate causes of the crisis.

Structural Incompatibility

It is not just a coincidence that Japan, Korea and Taiwan created and consolidated their East Asian models during the Golden Age. Northern growth was rapid and the demand for imports grew even faster. Since only a few Asian countries were vying for shares of Northern import markets, and were starting from a small base, their success posed no immediate threat to host countries. Cold War politics made the US hesitant to treat these countries too harshly; on the contrary, it provided substantial grants and loans to assist their development. Plus, the US pumped money into Asian countries in the course of prosecuting the wars in Korea and Vietnam. Finally, note that for much of the period, the movement of financial capital across national borders was slow, and controlled by

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[8] This aspect of East Asian economies has gradually changed. Government expenditures on social welfare and housing have risen rapidly in most countries, albeit from a low base.

[9] Of course, the US and its European OECD partners hardly have clean hands when it comes to the eradication of social inequality, gender oppression, and the coddling of entrenched elites.

national governments.

But the rise of the Neoliberal regime has created multidimensional tensions with developing countries that have adopted the Asian model. For one thing, East Asia's success offered proof that an intelligent and flexible combination of state regulation and market forces could achieve a combination of economic growth, productivity, technological progress, and income equality superior to anything Neoliberalism could offer. Until 1997, the unparalleled success of the Asian model was seen by many as proof that the idea embodied in the “Washington consensus” that “there is no alternative” to Neoliberalism was just an ideological slogan, not a fact. For another, it was true even in the Golden Age that export-led growth in the South could never be a permanently successful strategy for every developing country given limits to the growth of low to mid-tech global export markets. But the evolution of the Neoliberal regime with its chronically inadequate aggregate demand growth and structurally determined excess supply made these limits bind earlier and bite harder than otherwise would have been the case. Asian countries could not continue forever to increase exports at 8% a year in a global economy whose developed economies were growing at 2% a year. These constraints meant that sometime, somewhere, export-led developing countries were likely to experience severe problems.

As a result of conflicts between the structure of the East Asian models and the ideological and material interests of the G-7 nations and multilateral institutions, enormous pressure was applied to East Asian countries in the late 1980s and 1990s to deconstruct key components of their economic systems. Northern powers pressed with special vigor for liberalization of both domestic and international financial markets, and elimination of trade management and investment oversight. This pressure arose in part because the profits that firms, banks, and rentiers outside East Asia could earn from its economic miracle was severely restricted by Asian governments’ controls and regulations. Beyond this, Asia’s government-directed economies represented the last significant obstacle to the consolidation of global Neoliberalism. Western interests believed that they were in a “war” with East Asia over what kind of capitalism would dominate the early twenty-first century--US capitalism or East Asian capitalism; and they intended to win. Though they used many weapons in this war, financial liberalization was clearly central to their battle plans.

Financial Liberalization, Short-Term Capital Flows, and the Outbreak of Crisis

That the sought after financial liberalization was if fact achieved is demonstrated by the surge of capital inflows to East Asia in the 1990s. Figures 6 and 7 provide data on yearly inflows of short-term and long-term capital in four East Asian economies. These economies all experienced a substantial rise in short-term capital inflows in the 1990s. Long-term capital inflows rose in three of the four countries as well. It is important to emphasize the shift toward short-term lending, depicted in Figure 8. The short-term character of much of this capital reflects global lenders’ perceived need to maximize their liquidity—the ability to unwind any position quickly and with minimum loss, and created the potential for a lightning-fast bout of capital outflow. These short-term financial inflows created the preconditions for Minsky crises, especially in South East Asian countries such as Malaysia and Indonesia that lack deep financial markets, adequate regulation, and lender of last resort institutions.[10] The inflow of so much money in such a short time to so many different East

[10] Dymski (1998) and Kregel (1998) discuss the relationship between Minsky’s framework and the

Asian countries created the possibility of region-wide panics, contagions, and financial crises.

Moreover, the East Asian model is an integrated and coherent whole. Its impressive successes were the result of all key components working together. Breaking down some parts of the system while leaving others intact courted disaster. Opening Asia to unregulated capital inflows before making all the other changes that financial deregulation required made no sense. In particular, the deregulation of domestic and international financial markets and the elimination of state investment coordination in the context of traditional corporate and bank leverage ratios was a recipe for crisis. Corporate debt equity ratios of three or four are inherently vulnerable to profit or interest or exchange rate shocks.[11]

The huge and variable capital inflows to Asia set up a Catch-22 dilemma for Asian exchange rate regimes, which raised yet higher the likelihood of crisis. As Figure 3 shows, most East Asian countries adopted de facto fixed exchange rate regimes in the 1990s. This insured foreign investors against exchange rate losses. Fixed rates also required that national authorities control inflation and limit budget deficits—policies favored by foreign rentiers; they thus helped generate glowing evaluations by the IMF and World Bank as to the soundness of these economies, which only accelerated the speed of capital inflows. However, de facto fixed exchange rates made it impossible to eliminate current-account deficits. So when deficits did arise, governments had to use their limited reserves to defend the exchange rate. When investors began to withdraw funds because current account deficits threatened the exchange rate regime in 1997, governments were forced to use their exchange reserves even faster. When the exchange rate pegs were finally abandoned in the heat of the crisis, remaining reserves were too small to cover foreign debt repayment commitments. Default or IMF supervision were then the only remaining options.[12]

Under speculative bursts of capital inflows and outflows, however, flexible exchange rate regimes can lead to devastating exchange rate instability. Inflows raise exchange rates, causing current account deficits and domestic credit explosions; large outflows make it impossible for domestic firms and banks to repay foreign denominated debt. No small, trade-dependent country can tolerate the extreme exchange-rate volatility inherent in the Neoliberal regime. That is why capital controls are essential for such countries.

Thus, once Neoliberal forces had successfully orchestrated the liberalization of domestic financial markets and international capital flows, and weakened the structures of trade management and investment coordination, the Asian countries were placed in deep jeopardy no matter which

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Asian financial crisis.

[11] See Wade and Veneroso (1998). The high debt ratios of the Asian model follow logically from the fact that profits are low, while household savings and capital investment are high. High corporate debt levels are the inevitable result of using a banking system to transfer large volumes of household savings to the corporate sector to finance investment.

[12] The *Wall Street Journal* of October 16, 1998 makes the same argument about the untenability (hence Catch-22 aspect) of both fixed and flexible exchange rates, nothing that "misalignments and currency crashes are equally likely under pegged and flexible exchange rate regimes. In the 116 instances between 1976 and 1996 when currencies plunged 25% or more, half were operating with flexible exchange rate systems" (while obviously the other half were fixed or pegged).

exchange rate regime they adopted. It was only a matter of time until crisis came.

We will flesh out the dynamics of the Asian crisis and present a more detailed explanation of its causes, with special focus on the case of Korea, in section VI. But first, we look at the strengths and weaknesses of the explanations of the crisis offered by mainstream economists.

V. A Critical Evaluation of Neoclassical Theories of the Asian Economic Crisis

Most analyses of the Asian crisis have focused on the cycle of short-term capital flows into and out of the recently liberalized Asian financial markets. Outstanding treatments of theory and facts surrounding this financial cycle can be found in the work of non-mainstream scholars such as Wade (1998), Wade and Veneroso (1998), Akyuz (1998), Chang, Park and Yoon (1998), Grabel (1998), MacLean, Bowles and Croci (1998), and UNCTAD (1998). Of course, many mainstream economists have also presented theories to explain the Asian financial crisis. Before we present a more detailed view of the crisis via an analysis of the course of events in Korea, it will be useful to briefly review the debate within mainstream economics about the causes of Asian crisis. We preface this review by recalling a typology developed by Radelet and Sachs (1998). These authors argue that financial crises can have any of five causes: deteriorating macroeconomic fundamentals; moral hazard in loan markets; financial panic; asset bubbles; and disorderly workouts. Most economists' writings on the Asian financial crisis incorporate some combination of these elements; indeed, the debate is shaped along these lines. The IMF, for example, emphasizes the first two factors: they trace foreign-exchange and asset-market pressure to either inappropriate macroeconomic policies or flawed systems of financial intermediation and regulation. This coincidence is not surprising in that the list encompasses the research interests of most economists using the core conceptual categories of mainstream macroeconomics. In order, these five causes correspond to: models of efficient markets; asymmetric information models; models with multiple equilibria, especially the Diamond-Dybvig model of bank runs; models of sunspot equilibria and self-fulfilling prophesies; and "political economy" models with rent-seeking government officials.

There is something here for almost every Neoclassical economist. Indeed, there is something exhilarating, almost titillating for economists about the Asian crisis; for the opinions of a sizable band of economists revered in academia—Joseph Stiglitz, Jeffrey Sachs, Paul Krugman, Lawrence Summers, Martin Feldstein, Stanley Fischer, and so on—have been analyzed in excruciating detail in leading journals of world opinion. Political professionals like to say about careers in their field that "you find a horse and you ride him." Things are little different for economists interested in making their mark on Noriel Rubini's instantly famous Asian crisis homepage—you find a theoretical take and you ride it.[13]

[13] The most extreme example of this is perhaps the empirical sub-literature on whether banking and financial collapses (like those in Asia) have generally been foreshadowed by deteriorating macroeconomic or structural fundamentals. The one-time character of any given occurrence of financial crisis leaves too few degrees of freedom for a reliable test. Some enterprising economists have tried to overcome this constraint by building up a panel of different occurrences of banking and financial crisis in contemporary economic experience; by stretching the definition of crisis and the allowable range of countries, they are able to generate 50 or more events. This in turn makes it possible to use a multinomial probit model to test whether a number of macroeconomic and financial

The fundamental problem with most of this literature is, not surprisingly, the problem one finds in mainstream macroeconomics debates between New Keynesians and New Classicals (and the shades in-between): this debate is conducted using as a point of reference the perfectly coordinated, mistake-free Walrasian general equilibrium model. There is certainly nothing wrong with comparing outcomes in one's model of choice with the Walrasian case. The problem goes deeper, however, to an ingrained habit of contemporary debate in mainstream theory: the idea that the implications of a given idea can be understood—and thus accepted as important—only with respect to the deviations they introduce from Walrasian equilibrium. Models for which the Walrasian case is simply not applicable thus cannot be understood.

The debate over the Asian model has quickly taken on this sort of flavor: the focus is on the mechanism that drives one away from the efficient equilibrium assumed to be the natural resting place of the system. A good example of this approach is a recent paper by Chang and Velasco (1998). These authors adapt the Diamond-Dybvig model (1983) to show that a shortage of global liquidity combined with a shock that adversely affects borrower countries in the presence of short-term capital inflows can generate recessions driven in part by a debt-deflation multiplier. Clearly, these authors have generated a framework capturing many aspects of recent events in a clever and concise way.

The question is, where does an analysis of this sort go next? One move would be to attempt to add in additional realistic features based on stylized characteristics of Asian economies with respect to the labor process, the government sector, a household sector, and so on. But this is asking the Diamond-Dybvig framework to carry a lot more weight than it was designed to bear, given its origin as a simple demonstration of the possibility of bank runs. Not only would such realistic features conflict with the simplifying assumptions required to generate a closed-form equilibrium; but adding them would lead to confusion on the part of mainstream economists as to *which* realistic feature is generating *what amount* of inefficiency in the resulting second-best equilibrium. To pertain more fully to the unfolding crisis in Asia, this (and other) framework(s) must be stretched this way; but to do so takes them quickly beyond the formal limits that generated their explanatory force in the first place. The problem derives, at root, from theoretical economists' insistence on assuming that the Walrasian maintained hypothesis is meaningful—that in the absence of whatever mechanism is emphasized, the economy would be at (or near) an efficient economic outcome. It is possible to ask, "what else is missing?" only within the straitjacket imposed by whatever formalism underlies an author's results. To insist on bringing in factors that require loosening that straitjacket invites the suggestion that one doesn't understand the rules of this game.

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variables collected for these various events are useful indicators of banking crises. For example, Hardy and Pazarbasioglu (1998) build a model of this sort, then apply the parameters they obtain to the case of East Asia. They find that variables capturing the vulnerability of the banking and corporate sector predict the subsequent crises, but macroeconomic variables do not. One problem with this exercise is that it requires the assumption that, say, the US savings and loan crisis of the 1980s, the Japanese banking crisis of the early 1990s, and numerous bank runs in smaller countries around the globe in the past 20 years can be put into a uniform data set and manipulated using models that require a high degree of statistical regularity.

Another problem is empirical. One would like to move toward an empirical implementation of an idea like Chang and Velasco's. However, the formal restrictions required to generate equilibrium in their model do not permit the construction of a set of empirical propositions. A reduced form must be used, one that presumably includes the list of variables that could shift the parameters of central interest in this formulation. However, this reduced form will be almost indistinguishable from those generated by models based on very different premises—in this particular case, from the Hardy and Pazarbasioglu (1998) model discussed in footnote 13, which assumes efficient markets (and does not bother with the information asymmetry at the root of the Chang/Velasco framework). Suppose one found that variables representing structural features of the banking system, as Hardy and Pazarbasioglu do, matter empirically? It is unclear whether one is showing: á la Chang and Velasco, that the banking system has malfunctioned because of international liquidity shortages: á la Hardy and Pazarbasioglu, that lack of regulatory oversight and other structural problems in domestic banking systems are to blame; or something else altogether. Still, the sheer difficulty of getting significant coefficients with small time-series/cross-section samples poses a barrier, even if one swallows the objections raised in footnote 1.

We can sum up this discussion by generalizing a remark that Jeffrey Sachs made about IMF economists in his Financial Times article of December 13, 1997, "it defies logic to believe that the small group of 1,000 economists on 19th Street in Washington"—or for that matter a self-conscious academic elite not afraid to substitute a simplifying assumption for an institutional investigation—"should dictate the economic conditions of life to 75 developing countries with around 1.4 billion people"—or that their own debating conventions should dictate the terms on which matters of such importance must be understood.

Following every nuance of the burgeoning economic literature would be exhausting, if not impossible, in the manner of a cat chasing its own tail. The remainder of this section identifies the three central threads along which debate has flowed.

The Asian Model on Trial: The Neoliberal/Neoclassical Perspective

The Neoliberal view of the Asian crisis is espoused by economists at the IMF and World Bank, by business economists, and by conservative, largely US-trained academic economists, including many in elite universities in Asia and Latin America. Neoliberal economic theory is the official ideology of the Neoliberal regime. This view finds the roots of the Asian crisis in the inherent incompatibility of the external (Neoliberal) global environment and most Asian nations' internal economic structures and policies. This incompatibility is traced in part to self-dealing and rent-seeking, "crony capitalism," which the March 1998 issue of *Finance and Development* sees, *inter alia*, as the root of the crisis in Southeast Asia (see Grey and Kaufman, 1998). In countries where corruption is not present, the IMF position is that something must be wrong with either macroeconomic management or institutions. Since Asia's afflicted economies generally had strong macroeconomic fundamentals prior to the crisis, blame focuses on "weaknesses in financial systems and, to a lesser extent, governance." (IMF, 1998).[14]

[14] This argument trips over itself. The governments in crisis are blamed both for permitting weaknesses to emerge in financial systems (through the aforementioned over-regulation of flows) and for their inadequate financial supervision. The contradiction herein is resolved if one considers

This approach asserts that market fundamentals should drive observed outcomes, and government intervention can only worsen outcomes. Since only the Neoliberal approach fully embodies this view, "there is no alternative" to Neoliberalism. No East Asian model of centralized control over capital movements and investment can be permanently sustained because its costs--price distortions, misallocated resources and restricted access to Northern goods and financial instruments--will eventually become too large to bear. The crisis is thus not attributable to external forces such as currency speculation, but to the cumulation of internal inefficiencies. Any transition from government-controlled allocation to decentralized market allocation will, it is admitted, impose temporary costs of adjustment, but in the Neoliberal view, the permanent costs of not opening capital and product markets clearly exceed the one-time costs of transition.

The Asian Model on Trial: Economic Theory Weighs In

Broadly speaking, contemporary theoretical models can be divided into those with unique and those with multiple equilibria. The unique-equilibrium models invariably describe efficient outcomes along steady-state growth paths; the multiple-equilibrium models permit deviations from efficient outcomes for reasons ranging from missing information, to perverse parameters, to asymmetric information, and so on. Models of the second type, which as already mentioned encompass almost the entire research agenda of applied microeconomists and macroeconomists using mainstream methods, are being widely and variously applied to the Asian crisis. The apparent facts of the case fit well with the notion of a good equilibrium which is replaced by a bad one.

Models of this type have been used to identify problems in Asia. For ease, we consider just one strand within this stream--microfoundational models in which bubbles emerge due to incentive problems under asymmetric information. The fundamental problem is incentive incompatibility between a well-informed loan applicant and a less-informed lender: in finite-horizon games in which loan applicants pay interest and keep residual returns, applicants have an incentive to undertake riskier projects than lenders want to underwrite. The potential for *overlending* and/or a *bubble* then arises if lenders do not exercise adequate vigilance. Banking systems in which risks are guaranteed are especially likely to fall prey to this sort of moral hazard problem. This general approach has been used to indict deposit insurance as the culprit in the 1980s US savings and loan crisis and the Latin American debt crisis.[15]

Paul Krugman's web-published January 1998 paper proposes a moral-hazard theory of the East and Southeast Asian financial crisis incorporating these elements. Specifically, he argues that

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that it refers to financial systems already in transition from government-directed to market-based methods of allocation. Interestingly, a paper produced independently by economists at the IMF (Demirguc-Kunt and Detragiache, 1998) summarizes some empirical tests which conclude that financial liberalization increases the probability of banking crisis.

[15] The standard asymmetric-information models of the LDC debt crisis are Sachs (1984) and Eaton, Gersovitz, and Stiglitz (1986). These models advance the proposition that the debt crisis arose because the penalty for non-payment was too low and contractual terms could not be enforced. The recurrence of two currently prominent names from this earlier discussion gives pause. As Yogi Berra put it, "It's deja vu all over again."

each nation has a class of assets–especially land–that is fixed in quantity but has a variable return. Suppose the return to land can be either high or low with a given probability. Then under risk neutrality a fair price for this land is, (Probability of high return) x (Value of high return) + (Probability of low return) x (Value of low return). Krugman argues that a bubble in land values emerges when one set of bidders on these assets discards the low return, and thus bids their price up to the high-return value. The culprit is the domestic banking system, which supports this bidding-up because it is backed by implicit governmental guarantees against failure. The asset bubble then bursts when low returns occur, generating losses for banks that governments are unable to absorb. This sets off a contagion effect when depositors at banks holding overvalued assets of this sort realize that they stand to lose the next time a low-return outcome is drawn.[16]

Second Thoughts about the Neoliberal Regime: Economic Theory Changes its Mind

But what economic theory gives, it also takes away. The same asymmetric-information framework used by Krugman to demonstrate weak points in the Asian model has been deployed to defend it and cast suspicion back on the Neoliberal regime itself as the possible culprit. This counter-offensive draws strength from the fact that neither of the aforementioned attacks on the Asian model fits the facts very comfortably. Vis-à-vis the IMF's two-level attack, note that some countries affected in the current crisis have succeeded because of state-directed, interventionist macroeconomic and microeconomic policies, not despite them. Further, the spread of the Asian crisis to Latin America has hit hardest countries such as Brazil and Mexico that have made sustained efforts to rebuild their economies after the debt-crisis years using precisely the orthodox policies championed by the IMF. If the IMF was right, Latin America should have stayed clear of the Asian meltdown of 1997-98. Further, while Krugman's asset-bubble argument may apply to some features of recent Southeast Asian experience, it doesn't fit the situation of Korea at all, not to mention Latin America. As Dymski (1998b) observes, Korea's land and stock market bubble peaked nearly a decade ago; a variety of policy steps had reined in the worst excesses of that bubble before this crisis broke out.

This general line of attack is set out in a March 12 speech in Manila by Joseph Stiglitz, now Chief Economist at the World Bank (Stiglitz, 1998). According to Stiglitz, "Curiously many of the factors identified as contributors to East Asian economies' current problems are strikingly similar to the explanations previously put forward for their success." Here Stiglitz is referring to core results from applications of the asymmetric-information framework to the developing-country case, a method he pioneered.[17] Stiglitz argues that because asymmetric information and incentive

[16] A macroeconomic approach building on the same factors as Krugman's microfoundational model is McKinnon's "overborrowing syndrome" model, which focuses on the inadequate regulation of domestic banks with access to overseas financial borrowing. This approach was operationalized empirically by Kaminsky and Reinhart (1996), a contribution which has now provided a launching point for many applied papers on the Asian crisis.

[17] For example, Stiglitz and Uy argue that, "Several characteristics of financial sector interventions in East Asia stand out: they incorporated design features that improved the chances of success and reduced opportunities for abuse; interventions that did not work out were dropped unhesitatingly; and policies were adapted to reflect changing economic conditions." (Stiglitz and Uy, 1996: 249) They go on to argue, in opposition to Krugman's emphasis on moral hazard and government

incompatibility are fundamental features of unregulated credit markets, those markets are prone to market failure. East Asia has defended against market failure in several ways--government coordination of resource flows, limited scope for interest-rate movements, and close instead of arms-length relationships between borrowers and lenders. The success of these measures contributed to the rapid development of these economies. Indeed, he points out that the East Asian solution to credit-market failure permitted Asian governments to channel a remarkably high proportion of national output as savings into capital accumulation without chronic market instability. Stiglitz admits that there was some misallocation of credit in East Asia. But macroeconomic fundamentals there were strong, and these credit-misallocation problems do not prove that these systems are fundamentally flawed. Instead "the buildup of short-term, unhedged debt left East Asia's economies vulnerable to a sudden collapse of confidence." Thus, he concludes, it was financial deregulation followed by excessive short-term capital inflows, not corruption or credit misallocation attributable to government guarantees or regulatory laxity, that plunged East Asia into crisis.

Clearly, then, mainstream theories of the Asian crisis are inherently incapable of explaining either the successes or the failure of the Asian model. They are thus an inadequate foundation on which to build policies for reconstructing prosperity in Asia and the rest of the world.

VI. The Triple Crisis: Korea, Asia and the Neoliberal regime

We focus our analysis of the Asian crisis in this section on events in South Korea. Highly diversified, family-owned conglomerates, called chaebol, dominate Korea's key export markets as well a many of its essential domestic markets. The chaebol were the vehicles used by governments over the past decades to build Korea's technological, productivity and growth 'miracle'. Indeed, one might say that the Korean 'model' consisted of state regulation of the creation and evolution of the chaebol, largely, though not exclusively, through its control of credit flows.

In the 1990s many of the chaebol's key export markets--including semiconductor, autos, ship building, steel, petrochemicals, construction, capital goods, and electronic equipment--suffered from the chronic excess supply and secular deflationary pressure discussed above. They thus faced fierce competition in their struggle to maintain and increase market share. At the same time, Korea's long-period of tight labor markets, in concert with key political changes after the 'revolution' of 1987, strengthened the labor movement, building steady upward pressure on the growth of real wages. Caught between rising labor costs and downward price pressure in product markets, the chaebol sought relief through high rates of productivity growth in their domestic operations, and the movement of many of their lower tech operations into the cheap labor pools of South East Asia, just as Japan had done earlier. Both objectives required high rates of capital investment in the face of the low profit rates coercive competitors brought to these industries.

Meanwhile, a global pool of liquid financial capital ready to cross borders in pursuit of high short-term profits had risen to gargantuan proportions through the expansion of Neoliberalism--by

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intervention in financial crises, that: "financial crises occur with remarkable frequency in the absence of government intervention. Private monitoring apparently does not suffice to prevent a financial crisis. Moreover, no single financial institution will exercise sufficient care on its own to avoid financial distress."

1997 about $1.5 trillion moved through the foreign exchange markets every day. Partly in response to the dearth of high returns available in Northern markets in the early 1990s, an increasing proportion of hot money began to move in the direction of Asia. Heated competition developed among global bankers and investment fund managers to get the best opportunities that East Asia, South East Asia and China had to offer. Loan "pushing" became the order of the day, just as it had been in the Latin American debt buildup of the 1970s. By 1996 over $300 billion a year of foreign capital was flowing into developing economies; over $90 billion of these funds went to the five Asian nations that were to be hardest hit by the 1997 crisis.

Of course, Korean markets would not have been open to the inflow of hot money if the traditional tight control of capital flows into and out of the country we associate with the East Asian model had been kept intact. But powerful global agents such as the G7, the OECD, the IMF, the World Bank, and multinational banks and firms had exerted enormous economic and political pressure on Korea and other Asian countries to deregulate domestic financial markets and capital flows, and to reduce barriers to imports and FDI. Those who resisted this pressure were threatened with restricted access to Northern goods and financial markets and hostile treatment from international agencies. Especially in the 1990s, after the Cold War ended, external Neoliberal agents bullied the countries of the South without restraint.

Meanwhile, many of the East Asian banks, industrial and commercial firms, and elite families that had prospered and grown powerful as a result of the decades-long "miracle" came to believe that their future economic interests were tied more closely to developments in global than in domestic markets. They came to believe that their personal prosperity was less dependent on national well being than on unrestricted access to foreign markets. They knew that such access would not be forthcoming unless their own governments gave in to external pressures to liberalize domestic markets. These agents created a rising internal demand for liberalization that reinforced the external pressures faced by area governments.

In Korea, the internal pressure for liberalization came primary from the families that owned the chaebol. As noted, the chaebol felt they had no choice but to increase investment spending to survive the coercive competition they faced in their primary export markets. But their motives for undertaking this investment expansion were not simple or uni-dimensional. The long history of success they had achieved in gaining a foothold in increasingly important global markets led chaebol leaders to believe that they could become even bigger global players. Sometime in the early 1990s the chaebol developed excessively and unrealistically ambitious plans to become serious competitors to the most powerful Northern multinational corporations, contesting markets with them all over the globe through exports as well as foreign direct investment. The rise in the value of the yen after 1993, which the chaebol believed reflected a long-term trend, may have contributed to their ambitions. Thus, both pressure to survive and ambition to become more powerful--defensive and offensive motivations--combined to induce the chaebol to undertake huge investments in new capacity and in new technology at home and abroad.

Though the chaebols' gross profit rates were modest, contrary to popular belief, they were not much out of line with their foreign competitors (see Chang 1998, Table 2). However, their high debt/equity ratios generated oppressive interest burdens, which forced net profit rates well below average. As a result, the chaebol needed a great deal of new credit to finance this new investment.

Toward this end, they allied themselves with external Neoliberal forces to pressure the government to accelerate the pace of domestic financial market deregulation. In response, the government of Kim Young Sam permitted the establishment of 9 new merchant banks in 1994 and 15 more in 1996, most of them started by people who had made their fortunes in the informal curb market and had little or no experience in standard commercial banking. According to sources in the banking industry, the government exercised little regulation or control over these banks. They even failed to monitor them. The government apparatus had no idea what these banks were doing with either their asset commitments or liability structures. This total lack of banking oversight constituted a dramatic break with traditional East Asian practices. The chaebol took significant ownership positions in many of the new merchant banks, and borrowed extensively from them; most of this debt was short term. Thus, the chaebol became even more indebted to domestic institutions than was usual in the high debt-to-equity tradition of the Korean and Japanese models.

The chaebol and the new merchant banks also wanted unlimited access to foreign credit markets, in part because global interest rates were as much as 50% lower than those available in the still semi-regulated Korean market.[18] They therefore pressured the government to prematurely and excessively liberalize short-term inward capital flows--bank loans and portfolio capital. Liberalization of the capital account was also a requirement for membership in the OECD, which the chaebol sought in order to guarantee themselves access without discrimination to Northern goods and investment markets (Amsden and Eun, 1997). But the Korean government, under strong pressure from the chaebol, liberalized capital flows even faster than was required by the agreement with the OECD.

Thus, as a number of heterodox economists cited in Section V have noted, the preconditions for the outbreak of the crisis were created not by too much government interference in the private sector, or too much 'cronyism, but by the failure of the government to maintain its traditional responsibility to monitor and control economic activity in the national interest. We would argue, however, that one cannot fully understand *why* this excessive liberalization took place without an evaluation of the internal contradictions and tensions within Korea. External Neoliberal forces may be the main villains in this sad story, but they are not the only villains.

Thus, just when global financial markets were flush with money seeking to move into the new 'hot' markets of Asia, some Asian governments were tearing down the barriers that had previously prevented their free entry.[19] Fed by the ongoing euphoria associated with the East Asian boom, global investors exhibited their usual herd-behavior. Short-term foreign funds poured into Korea in 1994 through 1996, mostly in the form of bank loans. Some of the loans were directly to the chaebol, most were made to Korean banks, which relent much of the money to the chaebol. It is believed that the merchant banks used a significant part of their foreign borrowings to speculate in financial assets around Asia.

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[18]The difference between US and, especially, Japanese interest rates led to a wave of so-called "carry trades" in which multinational banks would borrow in Japan or the US at low rates, then relend the money to Korean firms or banks at rates that were high enough to create attractive margins, yet were still well below domestic rates in Korea.

[19] Of course, those governments that chose not to liberalize rapidly, such as Taiwan and China, stayed relatively insulated from the immediate effects of the subsequent financial crisis.

The result of the liberalization of short-term capital inflows in these circumstances was a doubling of foreign bank debt between 1994 and 1997 from about $60 B to about $120 B (not counting the debts of foreign branches of Korean banks). Total foreign debt was still not grossly out of line with the experience of other countries; the key problem was that over 60% of this debt was short-term, due within one year.

The chaebol had thus financed an ambitious and risky long-term capital investment boom primarily with short-term loans, a large part of which were owed to foreign lenders and therefore due in foreign currency. And the government, which had traditional regulated and restrained the chaebol in the nation’s interest, helped them do it.

It was not so much the expansion program itself that was the main source of danger, though it was risky and probably excessively ambitious. After all, in response to the same competitive pressures confronting the chaebol, major Northern MNCs were engaged in similar programs of capacity expansion across the globe in industries such as autos, steel and semiconductors, all of which were plagued by excess capacity. This is an era in which huge oligopolies are engaged in a competitive struggle to determine who will dominate global markets. The big question is: which firms will be left standing when the excess capacity created in this struggle is destroyed by deep recession, mass insolvency and bankruptcy. General Motors was expanding more or less in the same way as the Korean chaebol. The key difference in the Korean case was in the short-term and foreign mode of finance of the investment boom.

Despite the fact that both the IMF and the World Bank certified that the Korean economy was in sound condition in mid 1997, the stage was now set for the generation of a domestic and external financial crisis. Any one of a large number of not-unlikely developments would now trigger both kinds of financial crises: a devaluation of the won (which would require more won to pay back a given debt in dollars or yen), an under-valuation of the yen (which could erode export markets), increasing foreign interest rates, a domestic recession, a slowing of growth in key export markets, or any other source of profit problems for the chaebol.

Under such conditions, domestic financial turmoil could quickly induce a foreign exchange crisis, while any problem in external markets would tip the razor’s edge balance of the domestic economy. Foreign banks that begin to fear defaults on their short-term loans and portfolio investors that suspect a currency devaluation both know that the first banks and the first investors to withdraw their funds from the country will be the least likely to suffer. If the chaebol had trouble servicing their domestic loans, foreign banks and portfolio investors were likely to pull their money out of Korea. The situation was thus ripe for a panic or contagion, which would accelerate the collapse in the currency, raising the likelihood of the mass defaults that everyone feared. That the Korean government maintained an inadequate volume of foreign reserves, an amount perhaps equal to three months of imports, made the situation even more precarious.

Of course, events in the mid 1990s did build toward a crisis. Devaluation of the Chinese yuan in 1994 and the Japanese yen in after 1995, along with falling demand in key export markets such as steel, autos, and, especially, semiconductors, led to a rising current account deficit after 1994. In 1995 it rose slightly, to about 2% of GDP, but the deficit hit $24 B or near 5% of GDP in 1996. The government in the past had usually been quick to devalue the won in the face of deterioration in the current account, but despite evidence that the won was perhaps 10% overvalued in 1995 and 1996, several factors blocked such action. For one thing, the huge inflow of foreign capital in this period maintained upward pressure on the won that could not be easily offset through sterilization. Further, foreign investors had come to expect and to count on relative exchange rate stability in Asia; a sharp devaluation might spook them. Finally, the government feared that a falling exchange rate would make it harder for Korean firms and banks to pay back their rising foreign debt.

Korea's current account problems did not last long; the country moved back toward balance by mid 1997. Unfortunately, they lasted just long enough, given the other developments of the period, to help tip the country into crisis. Declining export growth led to declining profits and increasing excess capacity for the now highly-leveraged chaebol. This resulted in some key loan defaults and an increase in domestic nonperforming bank loans in the first half of 1997. Whether Korea would have been able to weather this disturbance in the absence of further problems will never be known, because in July 1997 the sharp devaluation of the previously fixed-rate Thai bhat triggered an outbreak of financial panic across Asia. But we do know this: if Korea's mid 1997 debt problems had been exclusively domestic, the economic collapse that began later that year and accelerated after the imposition of the IMF agreement in December would *not* have occurred. Korea would have suffered slower growth and financial difficulties to be sure, but not a depression and loss of economic sovereignty.

When the Asian crisis erupted there was a general flight of investor capital from Asian markets and Asian currencies. Foreign banks now refused to roll the loans over. Real and financial asset prices plummeted around the region, and exchange rates went into free-fall. After losing reserves in a futile attempt to support exchange rates, countries raised interest rates to try to stop the panic. The initial declines in asset prices in turn induced further "forced" asset sales by investors unable to meet their interest payments.

The destructive Neoliberal financial infrastructure within which Asia was now embedded meant that the onset of financial crisis in any country in the area would pull everyone down, the strong as well as the weak. The won lost about 20% of its value in the period before early December, when the IMF made its deal with Korea. Firms and banks with large dollar or yen debt were pushed toward bankruptcy and their desperate demand for dollars and yen kept downward pressure on the won. Interest rates rose again in response to a sharp upward re-evaluation of risk, while banks pushed near default began to refuse to extend credit to smaller businesses. Economic growth slowed and unemployment, almost unknown in post war Korea, rose--from 2% in November to almost 3% in December. A self-reinforcing cycle of declining growth, falling profits, rising unemployment, rising interest rates, falling interest coverage ratios, and rising bankruptcies was now well under way.

As the world watched in amazement and fear, a number of Asian countries turned from economic miracles to economic disasters in a matter of weeks! The New York Times pointed to "the transformation of South Korea from industrial giant to industrial pauper" (11/22/97). Neoliberal economists, who previously insisted that the success of the East Asian miracles had been generated by free-market policies, not state-led industrial policy, now claimed that the crisis was caused by the same powerful but inefficient state industrial policies whose existence they had previously denied. With many of its banks and corporations unable to meet the mounting interest and principal repayment demands of foreign bankers, and thus on the verge of private sector foreign loan defaults on a mass scale, the Korean government, after initial resistance, accepted in December a virtual takeover of their economy by the US controlled IMF.

Pouring Fuel on the Fire: The agreement between Korea and the US-IMF

We have argued that the evolution of the global Neoliberal regime made the eruption of a financial crisis in Asia at some time virtually inevitable. But the main agents of the Neoliberal regime did *not* intentionally create the Asian crisis. The crisis was the unintended outcome of its laws of motion, not the conscious objective of some international conspiracy. However, an examination of the core elements of the IMF agreement will make clear that the forces of the Neoliberal regime *did* consciously use the opportunity presented by the crisis to try to permanently defeat the Asian alternative to Anglo-American capitalism and open Asia to the fullest exploitation by external economic interests. Paradoxically, the consequences of the victory of the Neoliberal regime over Asian-style capitalism have fueled a global firestorm that is likely to scorch the Neoliberal regime itself as well as its constituent elites before it dies out.

The IMF agreements in Asia mandated institutional and policy changes which are unprecedented in their breadth and severity. The key elements of the IMF agreement with Korea were as follows:

- Austerity macroeconomic policies, including high interest rates and restrictive budget or fiscal policy;
- Independence of the Korean Central Bank from the rest of the government;
- Stringent banking regulations, requiring Korean banks to take immediate steps to meet the minimum capital/asset ratios specified in the 1986 Basle Accord;
- Labor law reforms allowing firms operating in Korea to fire workers at will;
- The removal of restrictions on imports, including Korea's virtual prohibition of the importation of Japanese autos;
- The removal of restrictions of foreign ownership of Korean banks and firms;
- The elimination of all forms of government influence over both domestic and international capital flows--including short-term capital inflows, which had triggered the immediate crisis.

The imposition of sky-high interest rates (including short rates as high as 30% at the beginning in December and January), restrictive fiscal policy, and tough new banking standards devastated output, employment and financial resiliency. Korean banks have always operated with lower equity/asset ratios (higher debt/equity ratios) than are permitted by the free-market oriented Basle standards. When the loan defaults of the crisis left them near insolvency, the imposition of the Basle standards forced banks to drastically cut loans, especially to small and medium size businesses. The resulting credit crunch then forced more firms into loan default, leaving banks even further away from compliance with the Basle standards. Together these policies created an ever-deteriorating cycle of bankruptcies, bank failures, declining production and rising unemployment. The vastly understated official unemployment rate has approached 8%, the highest rate in decades, and may climb above 10%--this in a country without a social safety net.

While devastating to the Korean economy, this wave of destruction created advantages for external forces and, to some extent, the *chaebol*. The collapse of the Korean economy has led to a large current account surplus--perhaps $35 billion in 1998, gained solely through a massive collapse of imports. This surplus will provide the dollars needed to repay foreign banks and the IMF. And the depressed stock market and undervalued won associated with the crisis make it possible for foreigners to buy Korean firms and banks at rock bottom prices. Labor law "reform," in turn, has already severely weakened the Korean labor movement, and in so doing, has begun to create the labor market “flexibility” demanded both by the *chaebol* and by foreign multinationals wishing to buy Korean firms.[20] The independent Bank of Korea, as expected, has pursued the objectives of domestic and foreign rentiers rather than those of the Korean people. It maintained high interest rates right through mid-summer, even as the credit crunch worsened and the economy collapsed. And, of course, some of the IMF dollars that came with the agreement were recycled to foreign lenders, thus avoiding at least temporarily a severe crisis of the global banking system.

The last three elements of the agreement open the Korean economy to unrestricted foreign exploitation. The US had been trying for decades to penetrate the Korean economy with only moderate success: it looks like the IMF will finally get the job done. Note that at present, about 99% of cars purchased in Korea are made by Korean firms. This will change dramatically when Toyota and Honda have unrestricted access to the market next year.

Taken together, the full implementation of these provisions would dismantle the structures and policy tools used by successive Korean governments to regulate business in the national interest--and hence to create the Korean economic “miracle”. For example, these conditions eliminate the government's ability to allocate domestic credit flows and regulate cross-border capital flows--the cornerstone of the Korean development model. If these agreements are permanently implemented, Korea will lack the tools needed to reconstruct a non-Neoliberal, East Asian style system. Korea will then end up Neoliberalized--like Mexico, Argentina, and Brazil before it.[21] Elite families and some powerful banks and firms may prosper; but the labor movement will deteriorate and two-thirds of the Korean population will face persistent economic insecurity and falling wages.

Internal and External Elites in Come Together in Asia: Why the Korea Government Accepted

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[20]The struggle in Korea in the aftermath of the IMF agreements is described in Crotty and Dymski, 1998a, 1998b, and 1998c. These articles pay particular attention to the attempt by the Korean Confederation of Trade Unions, the more independent, democratic and militant of the two major Korean union federations, to prevent the implementation of radical Neoliberal restructuring in Korea.

[21]Interestingly, in June 1998, when it had become clear that the economic collapse per se was not leading to a spontaneous economic restructuring of the sort the Neoliberals had in mind, the government stepped in and took direct administrative control of the restructuring process. We thus see once again that the Neoliberal commitment to free markets and disapproval of government interference in economic activity apparently evaporates when the interests of its constituent agents are not being well served by market processes alone.

the IMF Agreement

Most Koreans believe that the government had no choice but to accept whatever demands the US and IMF made, no matter how harmful to Korea's sovereignty and its economic future, because the costs of debt default or even a temporary debt moratorium would have been more catastrophic.

But it is quite likely that Korea could have held out for a less destructive agreement. To succeed at this, the government would have had to make a credible threat to proceed without an agreement if IMF and US demands became excessively destructive. For example, the government could have threatened to let Korean banks and firms default on their foreign bank loans. Alternatively, the government could have imposed a temporary moratorium on principal repayments (such as the one later imposed by Russia). The crucial point is that Korea did not need a "good" fallback position in order to credibly threaten to reject the devastating agreement offered by the IMF. In a bargaining situation, a threat whose enactment would severely damage its maker can be effective if it is sufficiently dangerous to the other participants as well. Prospective large-scale Korean defaults did pose a severe threat to other parties directly and indirectly involved in the negotiations. The risk was not just to Japanese, European and American banks: the international financial system itself could have been thrown into crisis if investors lost confidence in the IMF's ability to organize and lead an all-powerful global creditors' cartel. In sum, it would have been irrational for the IMF to refuse to aid Korea and risk a global financial crisis just because the government would accept some, but not all of its demands. The costs of a collapse of negotiations to the IMF and its backers would have exceeded the benefits from holding out for the disputed demands.

Why then did the government accept this remarkably onerous agreement? Answering this question again takes us back to the evolution of the Neoliberal regime. By the 1990s, internal and external elites had, to a significant degree, adopted similar beliefs concerning economic policies and structures. Powerful internal forces in Korea wanted much of the IMF deal for their own interests.

Discussions we held in March with representatives of the *chaebol* and with government officials established, to our surprise, that the *chaebol* were generally positive about the IMF agreement--though they were not at all happy with its imperious mode of its design and implementation. While they objected to some elements of the agreement, especially the dangerously high interest rates and the opening of the Korean economy to unrestricted Japanese imports, they believed the IMF deal would help them accomplish two key domestic economic and political objectives. First, the agreement would permanently undermine the power of the labor movement, paving the way for falling wages, labor market flexibility, and permanent job insecurity. Second, the agreement would give the *chaebol* complete independence from government regulation. If fully implemented, the agreement would create freedom for the *chaebol* to pursue company profits and owning-family financial interests inside Korea or around the globe, no matter what effect their decisions might have on the majority of the Korean people. So with the most powerful force in Korea now ready to substantially align itself with IMF objectives, a credible government threat of default or debt moratorium failed to emerge.

An analysis of the Korean side of the negotiations leading to the IMF agreement reinforces a key point made earlier. The evolution of the Neoliberal regime helped create economic and political elites in Asia that eventually saw their material interests as being aligned more closely with external Neoliberal agents than with the workers and citizens of their own countries. They became a domestic fifth column, working to destroy the foundations of the traditional Asian models from within.

The Asian IMF Agreements and the Future of the Neoliberal Regime

The IMF agreements in Asia were clearly understood in the West to signal the final defeat of Asian-style capitalism in the war between the systems. Former US Secretary of State Henry Kissinger commented that "what we are trying to engineer in some of these countries is clearly a revolution," while Federal Reserve Chairman Alan Greenspan proclaimed that "one of the most fundamental effects of the Asian crisis was 'a worldwide move toward the Western form of free market capitalism' instead of the competing Asian approach that only a few years ago looked like an attractive alternative model for nations around the world" (NY Times, 2/13/98). This triumphalism was summed up nicely by a Wall Street Journal headline which simply stated, "We Won".

But our analysis suggests that this will turn out to be a Pyrrhic victory. The ultimate cause of the Asian crisis lies in the contradictions of the global Neoliberal regime itself, most fundamentally in its chronic deficiency of aggregate demand. The policies of the IMF constitute one of the system's many sources of demand restraint. In response to the outbreak of recurrent financial crises built into the structure of the Neoliberal regime, the IMF has imposed austerity policies on scores of developing countries. Asia had been the only high-growth area in the world over the past twenty years. In the 1990s about half the growth in global GDP took place in East and South East Asia, even though only about 25 % of global production originates there. By 'conquering' Asia and forcing it into deep recession and perhaps depression, the IMF has increased global demand deficiency qualitatively. This cannot help but accelerate the ferocity of predatory and destructive competition sweeping global markets, creating even more severe problems of profitability, excess capacity, financial instability, banking crises, and commodity price deflation.

Current estimates of the expected rate of *decline* of real GDP in Asia in 1998 include: 2.5% in Japan, 15% to 20% in Indonesia, 7% in Malaysia, 8% in Thailand, 5% in Hong Kong, and 8% in Korea (*New York Times*, October 2, 1998). The impact of this economic collapse and the massive capital flight accompanying it has already spread to Russia, Latin America, and to US financial markets. Forecasts of a mild US recession in 1999 are now commonplace. With 40% of global GDP generated by countries already in recession, the end of growth in Europe and the US would quite likely lead to a global depression and deflation of historic proportions. In the end, even the global elites who created the Neoliberal regime and have received disproportionate shares of its booty will be unable to insulate themselves from the destructive dynamics they have unleashed.

VII. Policy Implications

Our analysis of the Korean crisis puts substantial emphasis on the large flows of short-term foreign capital that flooded the recently liberalized Korean economy in the mid 1990s. Such emphasis is consistent with the focus placed on large, volatile short-term capital movements in most mainstream and heterodox writings on the Asian crisis. Clearly the $105 billion change in net capital flows to Korea, Malaysia, Indonesia, Thailand and the Philippines--from a $93 billion net inflow in 1996 to a $12 billion outflow in 1997--an amount equal to more than 10% of the area's pre-crisis

GDP, played a major role in triggering the problems under review. This would be equivalent to a change in net capital flows of about $850 billion in the US economy, which would create an unimaginable degree of instability in US financial markets.

However, we have also attempted to look beneath unstable cross-border financial flows to the structure of the global economic regime within which these financial dynamics were taking place. A complete understanding of the causes and consequences of the Asian crisis, encompassing ultimate as well as proximate causes, requires an investigation of the basic contradictions of the global Neoliberal regime. But we stress the importance of a theory of the Neoliberal regime not just because it helps us better understand the current crisis, but also because it creates a policy perspective quite different from the one associated with most mainstream and heterodox crisis studies.

Neoclassical economists who acknowledge the existence of flaws in global capital markets have proposed that developing countries that experience foreign exchange problems be permitted to utilize certain kinds of temporary controls on inward, but not outward, short-term capital movements. Many heterodox economists go further. They support the use of permanent capital controls as part of the reconstruction of new versions of the East Asian model, ones better suited to current economic conditions and based on more genuine democratic control of the state than were their predecessors. See, for example, Chang (1998).

But our analysis of the crisis suggests that neither of these policy positions is fully adequate, either to repair the damage caused by the current global economic crisis, or to guide the creation of a global economic environment within which long-term, sustainable, egalitarian, high-employment growth is possible in both the North and the South. If we are correct, no new Golden Age era will be possible unless and until the fundamental structures and policies of the global Neoliberal regime are destroyed and replaced by institutions that support buoyant global aggregate demand, facilitate egalitarian national public and private sector institutions and rules-of-the-game, and tolerate different national paths to economic development. Of course, our argument does not suggest that pursuit of objectives short of a reconstitution of the structures of the global economic system are not of the utmost importance. On the contrary, the reimposition of national capital controls in pursuit of the reconstruction of effective and progressive national industrial policies are quite likely preconditions for success in the larger project. The key point is this: if we do not create global institutions that support such progressive national programs, it is far less likely that anyone will be able to successfully construct and maintain them.

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Figure 1: Systemic Interactions in the Golden Age and Neo-Liberal regimes

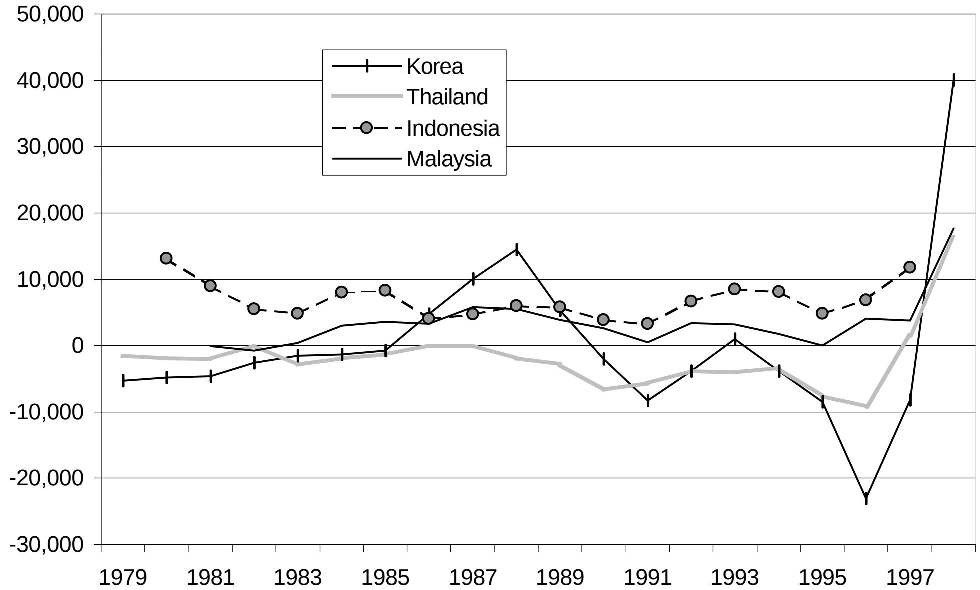
The Golden Age period, 1946-71

International financial relations: Bretton Woods fixed exchange rates; national controls over cross-border capital movement; small amount of stateless money	⇒	National economic policy: use aggregate-demand management to maintain low unemployment, engage in planning and market regulation to meet national goals
⇓		⇓
Firm objectives: Co-respective competition based on high-productivity, high-wage production; financial earnings secondary	⇐	Political context: Government regulation dictates how firms can compete in markets. Widespread public support for progressive taxes, redistributive government policy. Greater equity as a result

The Neo-Liberal regime, 1980-present

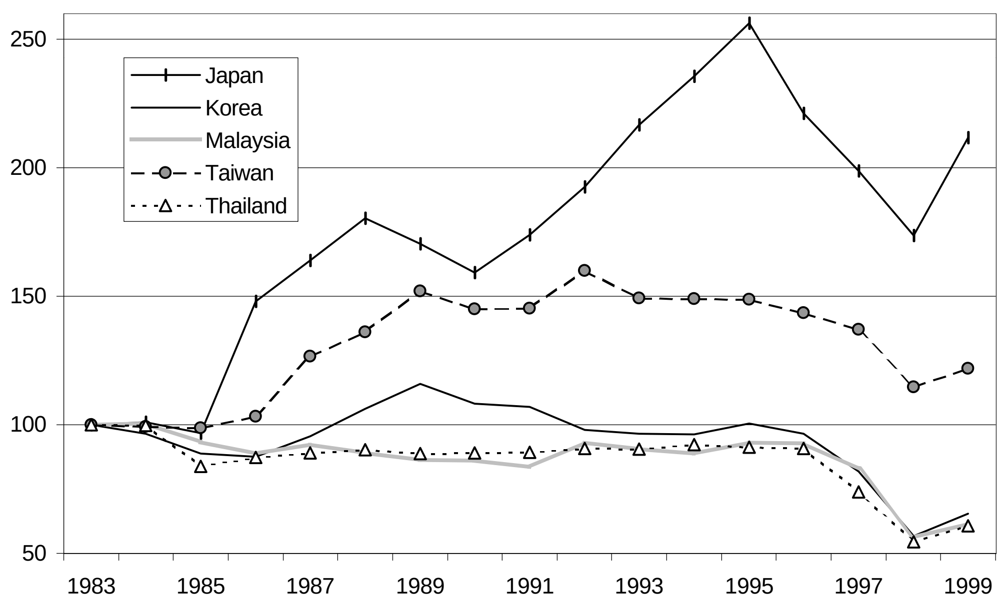
International financial relations: flexible exchange rates with chronic devaluations, eroding controls over cross-border capital movement; large volume of stateless money	⇐	National economic policy: retreat from aggregate-demand management; low-inflation target is substituted for low-unemployment target. Market-dictated resources flows instead of planned allocation of resources. Beggar-thy-neighbor moves in foreign exchange markets
⇑		⇑
Firm objectives: Multinational firms engage in coercive competition based on price-cutting and wage-slashing, seek financial profits from foreign-exchange position-taking	⇒	Political context: Political choices are restricted by multinational firms' threats; deregulation and regressive tax-policy shifts are forced. Less equity results. Public support focuses on policy rules (balanced-budget, tax levels) not on outcomes

Figure 2: Trade Balance for Three East Asian Countries, in Millions of Dollars, 1979-1998



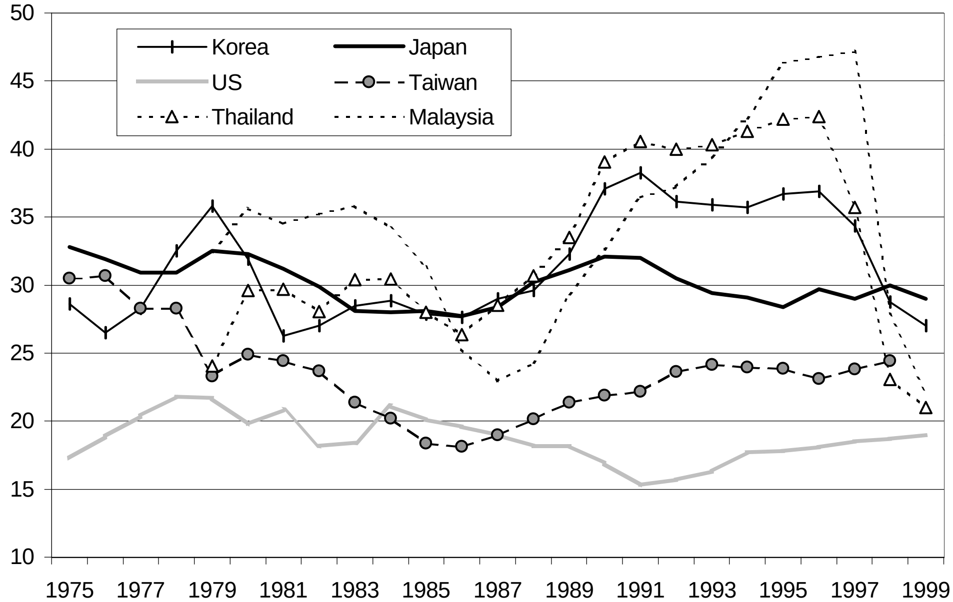
Source : Asian Development Bank.

Figure 3: Normalized Exchange Rates Relative to the Dollar, Five East Asian countries, 1983-99



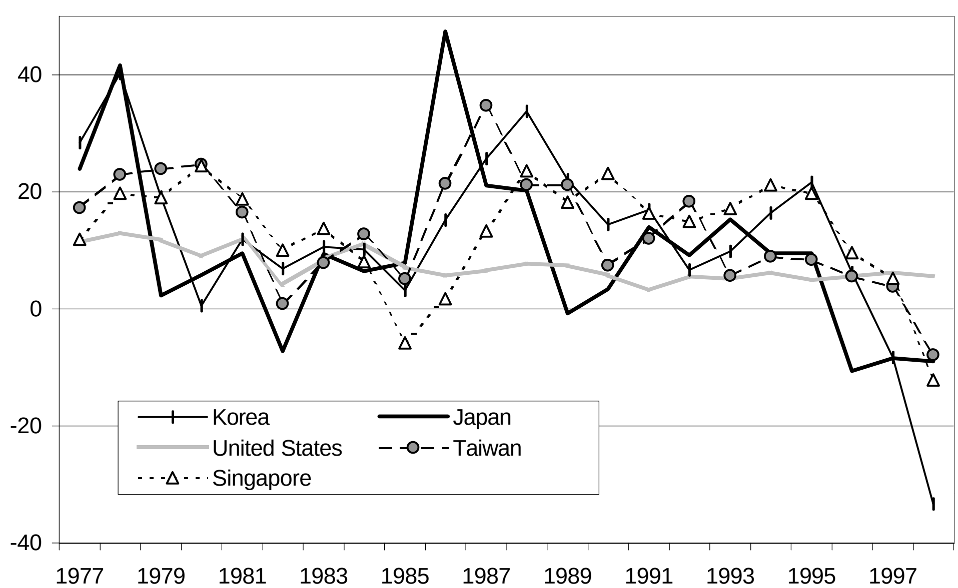
Source : Federal Reserve Board.
Note : Dollars per currency with July 1983 = 100. Upward shifts denote a weaker dollar.

Figure 4: Gross Investment as a Percentage of GDP, Selected Countries, 1975-99



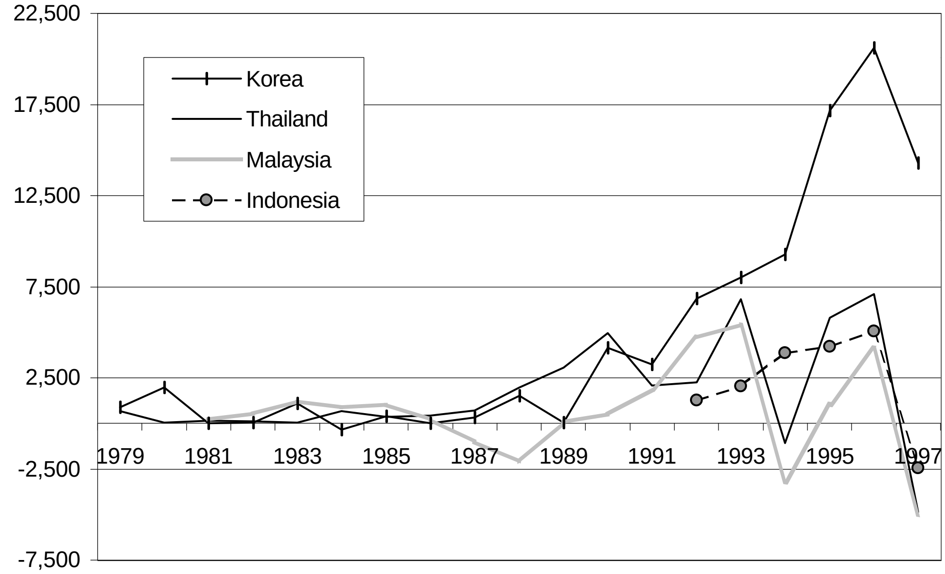
Source : Asian Development Bank, Bank of Korea.

Figure 5: Growth in GDP Measured in Dollars, Selected Countries, 1977-1998



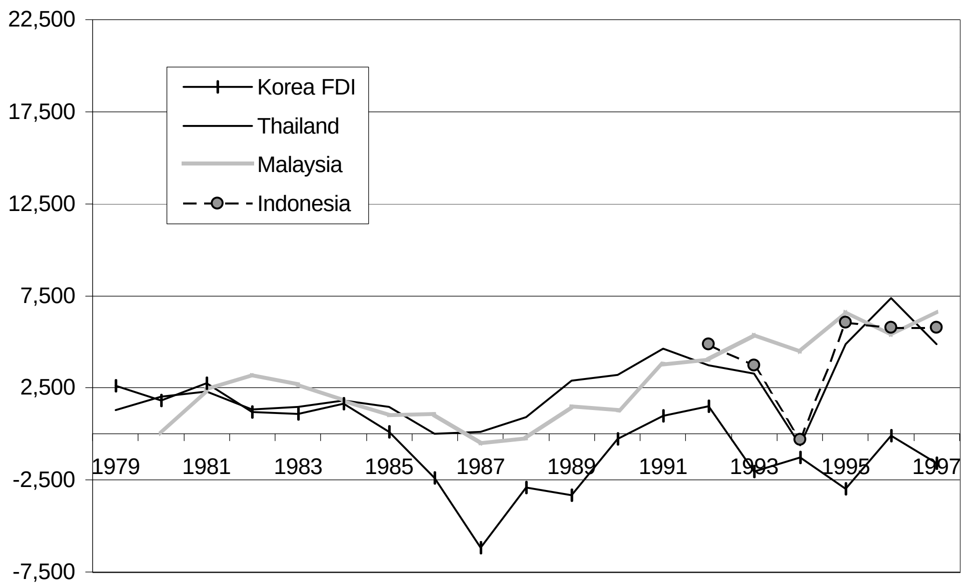
Source : Bank of Korea. *Note* : Changes in GDP are measured here in nominal US dollars, and thus reflect changes in both economic activity and exchange rates.

Figure 6: Short-Term Capital Inflows, Four East Asian Countries, in Millions of Dollars, 1979-1997



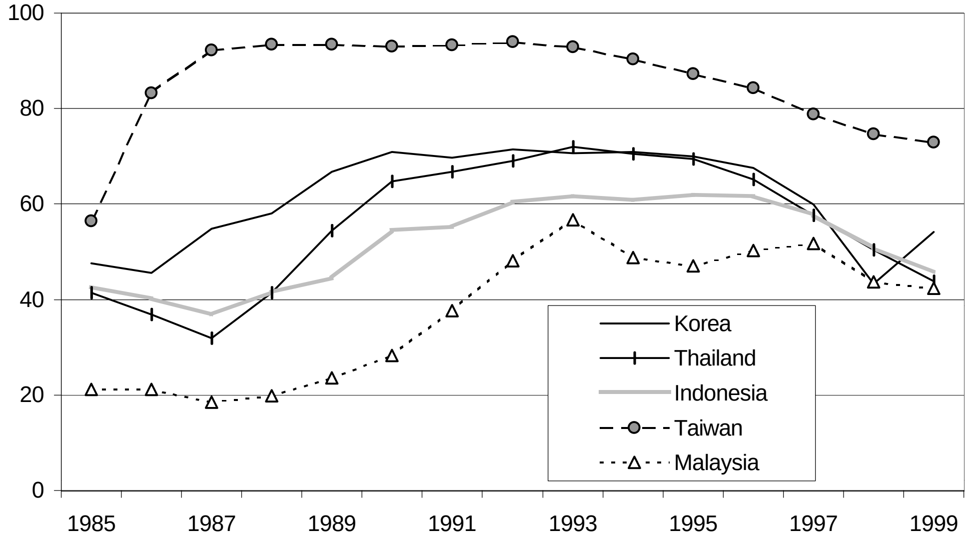
Source : Asian Development Bank.
Note : Figures include portfolio and other short-term inflows.

Figure 7: Long-Term Capital Inflows, Four East Asian Countries, in Millions of Dollars, 1979-1997



Source : Asian Development Bank.
Note : Includes foreign direct investment and other capital with maturity of over one year.

Figure 8: Short-Term Debt as a Share of All Debt for BIS-Reporting Institutions, Selected East Asian Countries, 1985-1999



Source : Bank for International Settlements.

Postscript

Two years have passed since this essay was published in *International Papers in Political Economy*. Our analysis, like many others at that time, emphasized the singular importance of the Asian financial crisis. In our view, market forces unleashed in this crisis had largely broken the power of the global economy's only significant remaining bloc of government-directed economies. And with the passing of the "Asian economic miracle," the possibility of an alternative to neo-liberal policies was severely wounded. Now, much more is being written about the reemergence of Asian economic growth. While the World Bank subtitled its September 1998 retrospective on East Asia "The Road to Recovery," its mid-2000 update, "Recovery and Beyond," reports with some relief, "East Asia is once again the world's fastest growing region" (v). Why has this occurred? And what then is the meaning of the Asian financial crisis?

A postscript cannot hope to definitively answer these questions. Instead, paralleling the logic of our 1998 paper, we first comment on changes in the global context of the Asian crisis. We then dissect the substance of the East Asian recovery by examining Korea post-crisis.

East Asia

The World Bank sets out its views about the questions above in "Recovery and Beyond." The Bank argues that "harsh but quick adjustment" has done its job; now further steps permitting integration with the global economy are needed. And "the international community can help by developing a framework that makes capital flows more manageable and less volatile and by continuing to reduce trade barriers" (2). The report's ensuing pages point out that growth in the five most affected large countries (Indonesia, Korea, Malaysia, the Philippines, and Thailand) shifted from –8 percent in the fourth quarter of 1998 (on a year-over-year basis) to +8 percent as of the third quarter of 1999. A closer reading finds a less euphoric picture. Korea's rebound in 1999 is most dramatic, but should not be overstated, as we discuss below. And Thailand's 1999 rate of growth was less than its 1998 decline, while Indonesia had negative growth in both 1998 and 1999.

How has this partial recovery been achieved? Have Japan, the US, and Europe's advanced economies been behind these trends? It seems unlikely. US economic growth is robust, but may be unsustainable. For one thing, US growth appears to be built on the unstable ground of a consumption boom linked to consumer debt accumulation and rising asset prices, and to an increasingly debt-heavy corporate sector. Further, this growth has lead to an historically unprecedented trade deficit. The combination of a booming stock market, government surplus, trade deficit, and capital-account inflow can be sustained only under increasingly implausible scenarios.

By contrast, other advanced nations' growth has slowed or behaved erratically. In particular, Germany's growth rate fell from 2.3 percent in 1998 to a lower level in 1999 before recovering slightly in early 2000. China's growth rate has also slowed. The exception to this pattern is Japan. It reversed its 1998 negative growth of –2.8 percent and climbed to a still-anemic 1 percent growth rate. Given that Japan's growth rate is the tail that wags the pace of East Asian expansion, as Figure 5 suggests, Japan's reversal may explain much of the overall

East Asian recovery. This is hardly an encouraging sign, since Japan remains mired in an intractable structural crisis involving political paralysis, a tottering banking structure, and a numbed and dissatisfied population.

It is important to remember that before the crisis, East Asia was the world's growth leader on the basis of its models of state-led growth. With the subsequent damage to and even dismantling of these models, there is no reason to believe that East Asia will resume this global role. East Asia's remarkable growth has resulted in part from dense trade and investment interrelations, but also from exports to other nations, especially advanced countries. Now, this region's growth depends even more on the pace of demand in the rest of the world economy.

And what about global growth? Overall, world economic growth fell from a pace of 4.2 percent in 1997 to 2.5 percent in 1998 before rising again in 1999 and early 2000. Much of the renewed pace of global expansion is driven by the historically unprecedented US trade deficit, which has helped East Asia's recovery both directly and indirectly (by absorbing EU exports and facilitating EU import demand). This good news is offset by two factors: first, the revived growth rate remains anemic relative to the pace of global labor-force growth; second, the US trade deficit is unsustainable in the long run, a fact reflected in the increasing turbulence of US financial markets. In sum, if the picture of global stagnation we described in 1998 has brightened at all, it is only at the expense of deeper global structural imbalances.

Our 1998 paper attributed weak global growth rates to the mutually reinforcing problems of insufficient growth in aggregate global demand and to chronic excess aggregate supply. Weak aggregate demand was in turn traced to five factors: forces holding down wages and mass consumption; high real interest rates; restrictive fiscal policy; the level and character of global investment; and the IMF. Among OECD nations, wages have increased only anemically since 1997; interest rates have climbed even higher; fiscal policies remain tight; and investment spending still flows systematically to lower-wage locations in both the developed and the developing world. So four of the five factors remain operative. The only exception is that the IMF has at least temporarily lost its grip as an enforcer of neo-liberal discipline. This has given developing economies more scope for pursuing policy mixes that have permitted recovery. But these policies' effects are dampened because they are being pursued while the advanced countries are pursuing go-slow economic policies.

For the five crisis countries, recovery from the brink is due to structural adjustments associated with wrenching downturns. These nations have rebuilt their reserve via large trade surpluses. These have been compiled despite flat export performance through the collapse of imports. Facilitating this recovery, as the World Bank noted, has been a shift toward looser fiscal policy. Budgetary surpluses relative to GDP have become more negative; from a 1997 range of zero to –1 percent, these five nations' ratios by 1999 had slipped to a range of –3 to –7 percent. Note that this shift occurred during a period in which external pressure and "partnership" with the World Bank have forced the IMF to back off.

These five countries' structural improvements have not come without cost. All five experienced a severe contraction in investment, as Figure 4 documents. Already heavy debt levels have worsened, and banks' non-performing loans have reached unprecedented levels: 40

percent in Thailand, 35 percent in Indonesia, 20 percent in Korea. Poverty has become more widespread, and households generally are contending with far greater economic insecurity.

The IMF, World Bank, and advanced countries' leadership have taken a distanced view of these adjustments and trends; for example, the above-mentioned World Bank report mentions "Legacies of crisis – and the new vulnerability" (11) without any apology. But by identifying effects without naming causes, this official discourse raises more questions instead of answering them. Consider the World Bank's discussion of looser fiscal policy as a factor in East Asian recovery. Do the larger deficit/GDP ratios signal activist policies that have helped in the resumption of growth, or are these ratios the (passive) result of the collapse of public revenues? Are the IMF and other capital providers now permanently permitting nations to maintain larger negative deficit/GDP figures without punishment? Or is this an emerging point of difference between the World Bank and the IMF?

Korea

We now revisit Korea, addressing three important questions about Korea's experience under IMF sponsored economic restructuring since late 1997. First, has the Korean economy undergone the miraculous economic recovery that neoliberals have claimed? Second, how have labor and the broad majority of the Korean people fared under neoliberal restructuring? Third, to what degree have the forces of global neoliberalism transformed the Korean economy from its state-guided past to its intended market dominated future?

In the last year and one half, Korea's economy has become a poster child for IMF restructuring. The Asian Development Bank describes Korea's "economic recovery and financial stabilization" following the crash of 1998 as "remarkable." By creating "flexibility" in Korea's notoriously "rigid" labor markets, aggressively tearing down the remaining barriers to imports and to real and financial capital inflows, shoring up the collapsing financial sector, and replacing the dead hand of government with private market forces, neoliberals argue, President Kim Dae Jung has brought Korea back from the edge of depression to a long-term, high-growth path in record time.

Evidence in support of this view is not hard to assemble. After falling almost 7 percent in 1998, Korean real GDP grew over 10 percent in 1999. While this two year growth of 3 percent is dramatically below the 15 percent that might have been expected in the absence of the Asian crisis, it does seem impressive given the trying circumstances of the period. The rate of unemployment, which peaked at 8.4 percent in early 1999, is approaching 4 percent in 2000 as the expansion continues. Korea's balance of trade, which had slipped to minus 5 percent of GDP in 1996, was a record $40B in 1998 -- over 10 percent of GDP, and $25 B in 1999. In combination with a huge inflow of foreign capital, these trade surpluses rebuilt Korea's foreign reserves toward comfortable levels. Most important, in the view of G7, IMF and World Bank leaders, has been the dramatic economic restructuring under President Kim's strong leadership: the transformation of a corrupt and inefficient pre-crisis "crony capitalism" to an open, market-driven economy, though still incomplete, assures that the initial post-crisis rebound will be self-sustaining.

A closer look at the data, however, suggests that the recent Korean "miracle" may not be all that miraculous. The modest GDP growth between 1997 and 1999 was created solely by a huge swing in the trade balance. GDP minus net exports was actually 9 percent lower in 1999 than in 1997. And the large cumulative trade surplus was achieved not by a significant rise in export earnings, but through a collapse in imports brought on by the deep recession and a dramatic fall in Korea's exchange rate. Per capita real gross national income – an index of economic performance that takes account of the impact of deteriorating terms of trade on national living standards -- fell almost 20 percent over these two years. Figure 5, which depicts several nations' GDP in dollar terms, gives some indication of the scale of this decline. Moreover, future export performance will obviously deteriorate unless the US continues to run record trade deficits, European growth does not decline, and exchange rates in China and Japan do not turn against Korea. Even under present favorable external conditions, the trade balance is approaching zero. Turning to non-trade categories, real consumption only attained pre-crisis levels in 2000, with much of its 1999 rebound driven by the increased spending of upper-income families enriched by increasing inequality. Fixed capital formation in 1999 was 18 percent below 1997's value, and is only now rebounding towards pre-crisis levels. Finally, note that after the initial period, in which the US and IMF brought the Korean economy to its knees by insisting on balanced government budgets and sky-high interest rates, both monetary and fiscal policy became quite expansionary. But Neoliberal authorities are now demanding a shift to fiscal and monetary conservatism to guard against inflation. In sum, the bounce-back after 1998 was based on temporary, not sustainable developments, and longer term growth prospects are nowhere near as rosy as neoliberals claim.

Beneath the macro level, the effects of the crisis on the labor movement and the bottom 80 percent of the income distribution suggest that the situation is even worse. The IMF's most important demand in its negotiated deal with Korea, reflecting the priorities of both domestic and foreign capital, was for deep, immediate 'reform' of Korea's flexibility-constraining labor laws. And in February 1998, mass firings as a managerial prerogative were legalized, even in Korea's giant conglomerates. Taking advantage of their new legal powers and the collapse in demand, chaebol firms fired about 30 percent of their workers on average. As demand picked up in 1999 and 2000, firms hired mainly part time or temporary labor. As a result, the percentage of Korean employees with permanent or regular jobs, already among the lowest in the industrialized world before the crisis, fell dramatically, from 58 percent in 1995 to 47 percent in mid-2000, causing a sharp rise in worker insecurity. So while the unemployment rate has fallen -- almost to 4 percent, at this writing, still double the pre-crisis rate -- the percent of permanent employees shows no sign of rising. Indeed, interviews with top-level chaebol representatives by one of the authors in June 2000 confirmed that Korean capital is determined to drive this percent even lower. No OECD country is close to Korea in this index of job and income insecurity; on average, 87 percent of employees in OECD nations have permanent or regular job status.

The leaders of the militant, democratic Korean Confederation of Trade Unions made valiant efforts to slow the juggernaut of neoliberal restructuring. Days lost to strikes were triple the 1997 level in both 1998 and 1999, and militant labor actions continue. The KCTU even tried to organize general strikes in 1998 and 1999 to break the restructuring momentum. To date, these efforts have not been successful for several reasons. Kim Dae Jung has met labor activism with fierce repression, including the arrest of virtually all union leaders involved in strike activity. The labor movement is still divided: the more conservative, pro-government Federation of Korean Trade Unions has refused to join forces with the KCTU. Moreover, the ever increasing split in the workforce between permanent and temporary workers makes it increasingly difficult for the KCTU to maintain labor unity. The media is universally anti-labor, and labor has no major allies, because the middle class fears that labor activism will destabilize the recovery, and the once powerful progressive student movement is virtually non-existent now.

While it would be imprudent to rule out a new outbreak of effective labor militance, realistically, prospects for labor do not look good. Continued government repression and chaebol aggression can be expected. Real wages have only now regained pre-crisis levels and job insecurity grows ever greater.

Meanwhile, inequality of income and wealth is rising rapidly. The Gini coefficient, which equaled .28 in 1997, now stands at .32; and the ratio of the income of the highest quintile of households to that of the lowest quintile has risen by 22 percent in just two years. Indeed, the real income of the top 20 percent rose substantially both in the collapse of 1998 and in the recovery of 1999. Meanwhile, the income of the 80 percent of housholds constituting the bottom four quintiles fell in both years by a total of almost 20 percent. Not surprisingly, poverty has also worsened since the crisis. The urban poverty rate, which stood at 8.5 percent in 1996, rose to 19 percent in 1998 before falling slightly to 15 percent. Korea, a country proud of its tradition of social solidarity, is discovering that there are no exceptions to the rule that neoliberalism generates rising inequality everywhere.

A full discussion of economic restructuring cannot be undertaken here. However, some important trends can be mentioned beyond the structural deterioration of labor rights addressed above. The most pressing problem facing the incoming Kim government was the collapse of a banking system overburdened with bad loans. To deal with this threat, the government injected a huge amount of public funds into the financial system; Standard and Poor estimated the ultimate cost at $125B, or about 29 percent of 1999 GDP. In effect, the banking system was temporarily nationalized. President Kim then used control of the banks to dictate structural change to the heavily indebted chaebol. Under the traditional Korean state-led growth model, high debt-equity ratios for chaebol companies were the norm, but liberalization followed by the outbreak of crisis in 1997 -- with its 30 percent interest rates, bank credit crunch, and collapsing sales -- left the highly indebted chaebol in extreme financial risk. Intent on rapidly installing a neoliberal regime, and on taking advantage of the public’s hatred of the families that controlled the chaebol, Kim Dae Jung demanded that the chaebol specialize on a smaller set of business areas and cut their debt-equity ratios from approximately 5 to under 2 in two years. He threatened to destroy them if they failed to do so, by cutting off credit from their main banks, which the government now controlled. Of course, in near-depression conditions, these firms could meet this demand only by selling off many of their assets to pay off their debts; since domestic firms were illiquid, such a process was guaranteed to dramatically increase foreign control of Korea’s economy. On paper at least, the chaebol have now met this requirement, though their absolute level of debt has dropped only about 10 percent. Most of the improvement has come in the denominator of the ratio, as firms raised the accounting value of their assets and issued new stock.

Just as President Kim intended, the forced sale of stock and real assets opened to door to an unprecedented rise in foreign ownership and control of the Korean economy. Foreign direct investment poured into Korea. After running between one and two billion dollars for most of the 1990s, inward FDI from early 1998 through early 2000 totaled almost $30B. It is projected to reach $20B in 2000 alone. Almost all of these inroads were achieved via mergers and acquisition; Korea thus gained few new real assets in return for this massive transfer of corporate control to outsiders. The full opening of the Korean stock market to foreigners, along with the outpouring of new stock offerings by chaebol firms pressed to lower debt-equity ratios, vastly increased the function of the stock market as a market for corporate control, and increased its volatility -- the KOSPI stock price index was 350 in late 1997, rose to near 1000 in mid 1999, and dropped to about 600 in September 2000. About $10B of net foreign money flowed into the Korean stock market in the past two years. Foreigners owned only 12 percent of the Korean stock market in late 1997, but 30 percent by early 2000.

Mainstream economists applaud the contribution these inflows of foreign capital to Korea's foreign exchange holdings. But these inflows have a longer-run downside: Korea is clearly losing control of its economic destiny to those who do not have its interests at heart. Much of the recent economic expansion was concentrated in a few key industries – such as semiconductors, telecommunications, and autos, all of which are falling under strong foreign influence. The Korea Times (7/17/2000) reported that foreigners owned 44 percent of semiconductor shares, and 21 percent of telecommunication shares. The situation in autos is well known. Renault bought Samsung auto (at about 10 percent of the value of its assets), Daimler-Chrysler is increasing its influence over Hyundai-Kia, and Kim Dae Jung has announced that Daewoo, Korea's largest auto maker, *must* be sold to foreign interests, even though its sale will bring little money, perhaps $3B, less than 3 percent of the cost of the government's bailout of the financial system. The Financial Times (6/27/2000) sees "the possibility that the entire [Korean auto] sector, the second largest in Asia, could soon be dominated by foreigners." Forbes (9/18/126), in an article titled "If You Can't Beat Em, Buy Em," predicts that the cash-rich Big Three in autos will soon take control of Daewoo and Hyundai for the express purpose of preventing the Korean firms from becoming serious competitors in the most profitable parts of the market – SUVs, sedans and minivans. That is, they wish to keep these companies from developing – hardly a wonderful prospect for the Korean economy.

In our view, then, the widely advertised neoliberal Korean 'miracle' is largely fraud. The sources of growth to date are unsustainable, intermediate term impediments to growth are numerous, and the restoration of long-term growth at historic rates is unlikely. The labor movement and the vast majority of the Korean people are clearly worse off because of neoliberal restructuring. Even the chaebol -- who are delighted by the decline in labor's power -- might sometimes wish they could put the genie back in the bottle, as their independence from foreign control rapidly vanishes. The trends in FDI and stock ownership, including the recent rise in foreign ownership of financial institutions, clearly reinforce a key concern raised in the body of our article in late 1998: Korea has moved substantially if not irrevocably towards a situation in which future Korean governments will be structurally incapable of guiding or regulating the Korean economy in the interests of the people of Korea.

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